

VISIT...

LANZAROTE
Caliente.COM



ARTICLE

Why do some of the
best companies languish
when markets change?

Because they insist on
doing *only* what has
worked in the past.

*New sections to
guide you through
the article:*

- *The Idea in Brief*
- *The Idea at Work*
- *Exploring Further...*

Why Good Companies Go Bad

by Donald N. Sull

MANY leading companies plummet from the pinnacle of success to the depths of failure when market conditions change. Because they're paralyzed? To the contrary, because they engage in too much activity—activity of the wrong kind. Suffering from **active inertia**, they get stuck in their tried-and-true activities, even in the face of dramatic shifts in the environment. Instead of digging themselves out of the hole, they dig themselves in deeper.

Such companies are victims of their own success: they've been so successful, they assume they've found *the* winning formulas. But these

same formulas become rigid and no longer work when the market changes significantly.

When companies understand that action can be the enemy, they are less likely to join the ranks of the fallen. Before asking, "What should we do?" and rushing into action, managers should ask, "What hinders us?" They should look deeply at the assumptions they make about their business and industry. And they should pay particular attention to hallmarks of active inertia: strategic frames becoming blinders, processes hardening into routines, relationships becoming shackles, and values hardening into dogmas.

THE following examples demonstrate the disastrous effects of active inertia:

- **Strategic frames become blinders.** Strategic frames shape how managers view their business; they help managers stay focused. But these frames can also blind managers to new options and opportunities.

EXAMPLE:

After seven decades of uninterrupted growth, Firestone reigned supreme in the U.S. tire industry in the 1970s. Then Michelin introduced the safer and more economical radial tire. Firestone competed with Michelin head-to-head in Europe, but was blind to the threat to its core U.S. market, and so continued to produce conventional tires only. Firestone lost significant market share and was acquired a decade later.

- **Processes harden into routines.** Established processes can become ends in themselves, even when they're no longer effective. People overlook better ways of working.

EXAMPLE:

McDonald's built its success on standardized processes, all dictated by headquarters. By rigidly following these procedures into the 1990s, McDonald's lost market share to Burger King and Taco Bell, who were much quicker to meet customers' changing desires for healthier foods.

- **Relationships become shackles.** Every company needs strong relationships with its constituencies—customers, suppliers, employees. When conditions change, however, these relationships can restrict flexibility.

EXAMPLE:

Apple's vision of technically elegant computers and its freewheeling culture attracted the world's most creative engineers. Once computers became commodities, however, the company's health depended on cutting costs and speeding up production time. But Apple's engineers refused to change, and the company's relationship with its "star" employees damaged its ability to respond to market changes.

- **Values harden into dogmas.** A company's vibrant values unify and inspire its people. Over time, however, they can harden into rigid, self-defeating rules and regulations.

EXAMPLE:

Polaroid placed very high value on cutting-edge research—to the point of defining itself by that research. Eventually, that value turned into dogmatic disdain for marketing, finance, and even customer preferences. The company's single-mindedness nearly destroyed it.

WHY GOOD COMPANIES GO BAD

by Donald N. Sull

When business conditions change, the most successful companies are often the slowest to adapt. To avoid being left behind, executives must understand the true sources of corporate inertia.

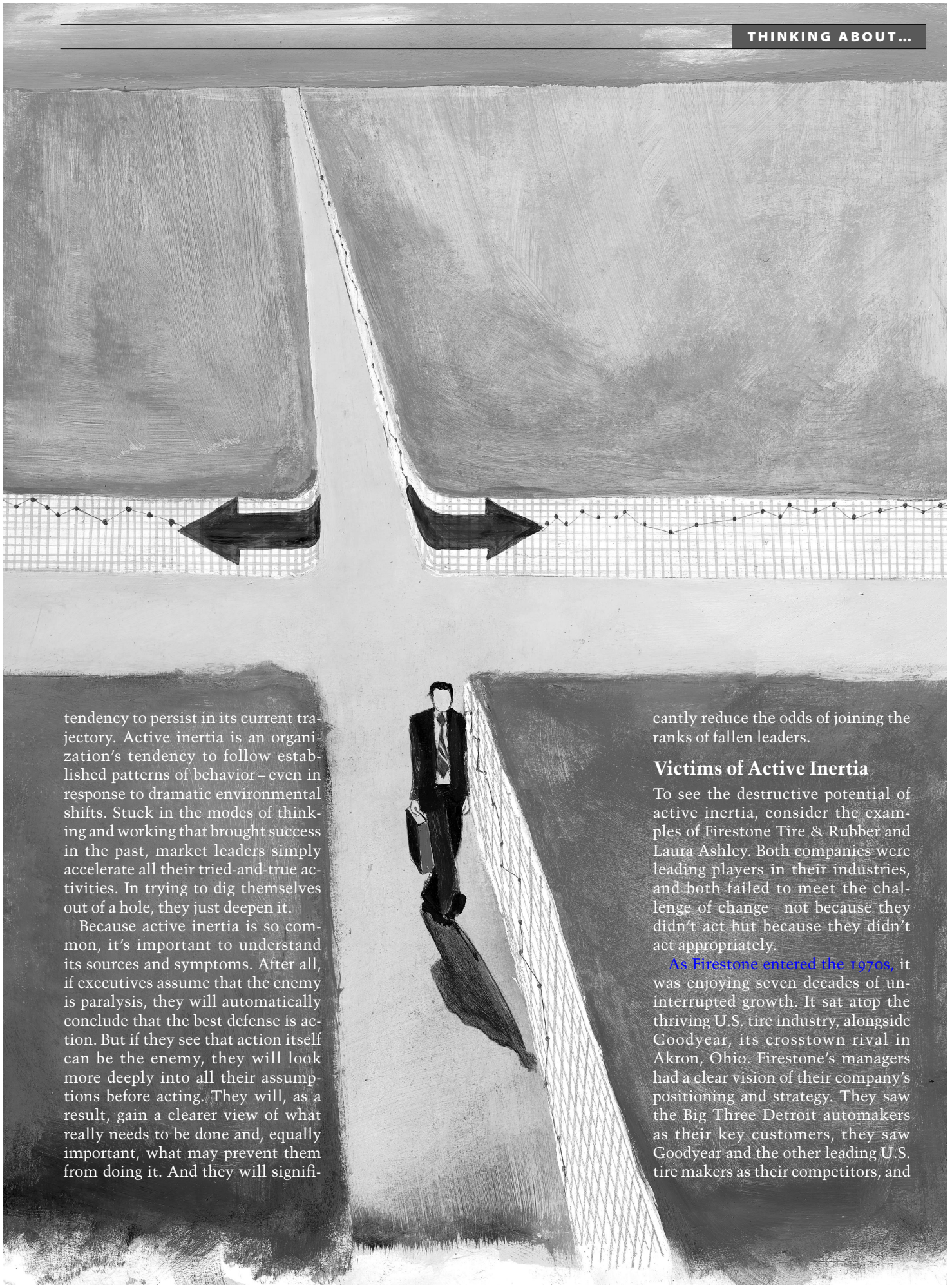
ONE OF THE MOST COMMON business phenomena is also one of the most perplexing: when successful companies face big changes in their environment, they often fail to respond effectively. Unable to defend themselves against competitors armed with new products, technologies, or strategies, they watch their sales and profits erode, their best people leave, and their stock valuations tumble. Some ultimately manage to recover—usually after painful rounds of downsizing and restructuring—but many don't.

Why do good companies go bad? It's often assumed that the problem is paralysis. Confronted with a disruption in business conditions, companies freeze; they're caught like the

proverbial deer in the headlights. But that explanation doesn't fit the facts. In studying once-thriving companies that have struggled in the face of change, I've found little evidence of paralysis. Quite the contrary. The managers of besieged companies usually recognize the threat early, carefully analyze its implications for their business, and unleash a flurry of initiatives in response. For all the activity, though, the companies still falter.

The problem is not an inability to take action but an inability to take appropriate action. There can be many reasons for the problem—ranging from managerial stubbornness to sheer incompetence—but one of the most common is a condition that I call *active inertia*. Inertia is usually associated with inaction—picture a billiard ball at rest on a table—but physicists also use the term to describe a moving object's

Donald N. Sull is an assistant professor of strategic and international management at London Business School.



tendency to persist in its current trajectory. Active inertia is an organization's tendency to follow established patterns of behavior—even in response to dramatic environmental shifts. Stuck in the modes of thinking and working that brought success in the past, market leaders simply accelerate all their tried-and-true activities. In trying to dig themselves out of a hole, they just deepen it.

Because active inertia is so common, it's important to understand its sources and symptoms. After all, if executives assume that the enemy is paralysis, they will automatically conclude that the best defense is action. But if they see that action itself can be the enemy, they will look more deeply into all their assumptions before acting. They will, as a result, gain a clearer view of what really needs to be done and, equally important, what may prevent them from doing it. And they will signifi-

cantly reduce the odds of joining the ranks of fallen leaders.

Victims of Active Inertia

To see the destructive potential of active inertia, consider the examples of Firestone Tire & Rubber and Laura Ashley. Both companies were leading players in their industries, and both failed to meet the challenge of change—not because they didn't act but because they didn't act appropriately.

As Firestone entered the 1970s, it was enjoying seven decades of uninterrupted growth. It sat atop the thriving U.S. tire industry, alongside Goodyear, its crosstown rival in Akron, Ohio. Firestone's managers had a clear vision of their company's positioning and strategy. They saw the Big Three Detroit automakers as their key customers, they saw Goodyear and the other leading U.S. tire makers as their competitors, and

they saw their challenge as simply keeping up with the steadily increasing demand for tires.

The company had become a monument to its own success. Its culture and operations reflected the vision of its founder, Harvey Firestone, Sr., who insisted on treating customers and employees as part of the "Firestone family." The Firestone country club was open to all employees, regardless of rank, and Harvey himself maintained close friendships with the top executives of the big carmakers. (In fact, his granddaughter married Henry Ford's

grandson.) Firestone created fiercely loyal managers, steeping them in the company's family values and in its Akron-centered worldview.

The company's operating and capital allocation processes were designed to exploit the booming demand for tires by quickly bringing new production capacity on line. In the capital-budgeting process, for example, frontline employees identified market opportunities and translated them into proposals for investing in additional capacity. Middle managers then selected the most promising proposals and presented them to top executives, who tended to speedily approve the middle managers' recommendations.

Firestone's long-standing success gave the company a strong, unified sense of its strategies and values, its relationships with customers and employees, and its operating and investment processes. The company had, in short, a clear formula for success, which had served it well since the turn of the century.

Then, almost overnight, everything changed. A French company, Michelin, introduced the radial tire to the U.S. market. Based on a breakthrough in design, radials were safer, longer-lasting, and more economical than traditional bias tires. They had already come to dominate European markets, and when Ford declared in 1972 that all its new cars would have radials, it was clear that they would dominate the U.S. market, too.

Firestone was not taken by surprise by the arrival of radials. Through its large operations in Europe, it had witnessed firsthand the European markets' quick embrace of radial tires during the 1960s. And it had developed forecasts that clearly indicated that radials would be rapidly accepted by U.S. automakers and consumers as well. Firestone saw radials coming, and it swiftly took action: it invested nearly \$400 million—more than \$1 billion in today's dollars—in radial production, building a new plant dedicated to radial tires and converting several existing factories.

Although Firestone's response was quick, it was far from effective. Even as it invested in the new product, it clung to its old ways of working. Rather than redesign its production processes, it just tinkered with them—even though the manufacture of radial tires required much higher quality

standards.

In addition, the company delayed closing many of its factories that produced bias tires, despite clear indications of their impending obsolescence. Active inertia had taken hold.

By 1979, Firestone was in deep trouble. Its plants were running at an anemic 59% of capacity; it was renting warehouses to store unsold tires; it was plagued by costly and embarrassing product recalls, and its domestic tire business had burned more than \$200 million in cash. Although overall U.S. tire sales were plateauing, largely because radials last twice as long as bias tires, Firestone's CEO clung to the assumption of ever-growing demand, telling the board that he saw no need to start closing plants. In the end, all of Firestone's intense analysis and action was for naught. The company surrendered much of its share of the U.S. market to foreign corporations, and it suffered through two hostile takeover bids before finally being acquired by Bridgestone, a Japanese company, in 1988.

The women's apparel maker Laura Ashley also fell victim to active inertia. The company's eponymous founder spent her youth in Wales, and she started the business with her husband, Bernard, in 1953 as a way to re-create the mood of the British countryside. The company's garments, designed to evoke a romantic vision of English ladies tending roses at their country manors, struck a chord with many women in the 1970s. The business grew quickly from a single silk-screen press in Laura and Bernard's London flat to a major retailer with a network of 500 shops and a powerful brand the world over.

Laura Ashley expanded her tiny operation not to maximize profits but to defend and promote traditional British values, which she felt were under siege from sex, drugs, and miniskirts in the 1960s. From the beginning, she and Bernard exercised tight control over all aspects of the

business, keeping design, manufacturing, distribution, and retailing in-house. The couple opened a central manufacturing and distribution center in Wales, and they proudly labeled their garments "Made in Wales." They provided generous wages and benefits to their employees, thereby avoiding the labor unrest that crippled many British industries throughout the 1970s. They also established close relationships with their franchisees and customers, who grew fiercely loyal to the company's products and the values they embodied.

When Laura died in 1985, Bernard kept the company on the course his wife had set. Fashion, however, changed. As more women entered the workforce, they increasingly chose practical, professional attire over Laura Ashley's romantic garb. Competitors publicly dismissed the Laura Ashley style as better suited to milkmaids in the 1880s than CEOs in the 1980s. At the same time, apparel manufacturing was undergoing a transformation. With trade barriers falling, fashion houses were rushing to move production offshore

The fresh thinking that led to a company's initial success is often replaced by a rigid devotion to the status quo.

or to outsource it entirely, dramatically reducing their operating costs. Laura Ashley, in contrast, continued to pursue the outdated designs and the expensive manufacturing processes that had served it so well in the past.

The company did not, however, suffer from paralysis. By the late 1980s, an outside consultant had identified the major challenges facing Laura Ashley and had outlined remedial actions. Recognizing the need to act, the board of directors, chaired by Bernard, brought in a series of new CEOs, asking each to develop and carry out a restructuring plan that would increase sales and cut costs. The new plans set off flurries of activity, but none of them went far enough in recasting the company's strategy. It remained unclear whether Laura Ashley was a brand, a manufacturer, a retailer, or an integrated fashion company. Nor did the plans refresh the company's traditional values to bring them in line with the marketplace. Afflicted with active inertia, Laura Ashley went through seven CEOs in a decade, but the company's decline continued. American televangelist Pat Robertson recently joined the board as an outside director, leading one financial journal to conclude that the company sought divine inspiration for its earthly problems.

The Four Hallmarks of Active Inertia

To understand why successful companies like Firestone and Laura Ashley fail, it is necessary to examine the origins of their success. Most leading businesses owe their prosperity to a fresh competitive formula—a distinctive combination of strategies, processes, relationships, and values that sets them apart from the crowd. As the formula succeeds, customers multiply, talented workers flock to apply, investors bid up the stock, and competitors respond with the sincerest form of flattery—imitation. All this positive feedback reinforces managers' confidence that they have found the one best way, and it emboldens them to focus their energies on refining and extending their winning system.

Frequently, though, the system begins to harden. The fresh thinking that led to a company's initial success is replaced by a rigid devotion to the status quo. And when changes occur in the company's markets, the formula that had brought success instead brings failure. (See the exhibit "The Dynamic of Failure.") In particular, four things happen:

Strategic frames become blinders.

Strategic frames are the mental models—the mind-sets—that shape how managers see the world. The frames provide the answers to key strategic questions: What business are we in? How do we create value? Who are our competitors? Which customers are crucial, and which can we safely ignore? And they concentrate managers' attention on what is important among the jumble of raw data that crosses their desks and computer screens every day. The strategic frames of Firestone's managers, for example, focused their eyes on their competitors around Akron and their customers in Detroit. The frames also help managers see patterns in complex data by fitting the information into an established model. In Laura Ashley's heyday, its strategic frames enabled its executives to quickly judge potential product extensions based on their fit with traditional English style.

But while frames help managers to see, they can also blind them. By focusing managers' attention repeatedly on certain things, frames can seduce them into believing that these are the only things that matter. In effect, frames can constrict peripheral vision, preventing people from noticing new options and opportunities. Although Firestone competed head-to-head with Michelin in Europe and had witnessed the rapid rise of radial tires there, its leaders still couldn't see the French company

as a serious competitor in their core domestic market. As a strategic frame grows more rigid, managers often force surprising information into existing schema or ignore it altogether. Laura Ashley's managers repeatedly dismissed sales declines as temporary fluctuations rather than as indicators of basic shifts in women's fashion.

Sadly, the transformation of strategic frames into blinders is the rule, not the exception, in most human affairs. Consider the disastrous evolution of France's military strategy during the first half of this century. At the turn of the century, French military doctrine glorified attack, reflecting a belief that *élan vital* would prevail over all odds. But the attack-at-all-costs strategy proved disastrous in the trenches of World War I. As a result, the country's military changed its strategic frame and adopted a purely defensive posture, which took concrete form in the Maginot Line, a series of fixed fortifications erected to protect France's borders from German invasion. These fixed defenses, however, proved worthless in halting blitzkrieg

The Dynamic of Failure

Leading companies can become stuck in the modes of thinking and working that brought them their initial success. When business conditions change, their once-winning formulas instead bring failure.

Strategic Frames

The set of assumptions that determine how managers view the business

Blinders

Processes

The way things are done

Routines

Relationships

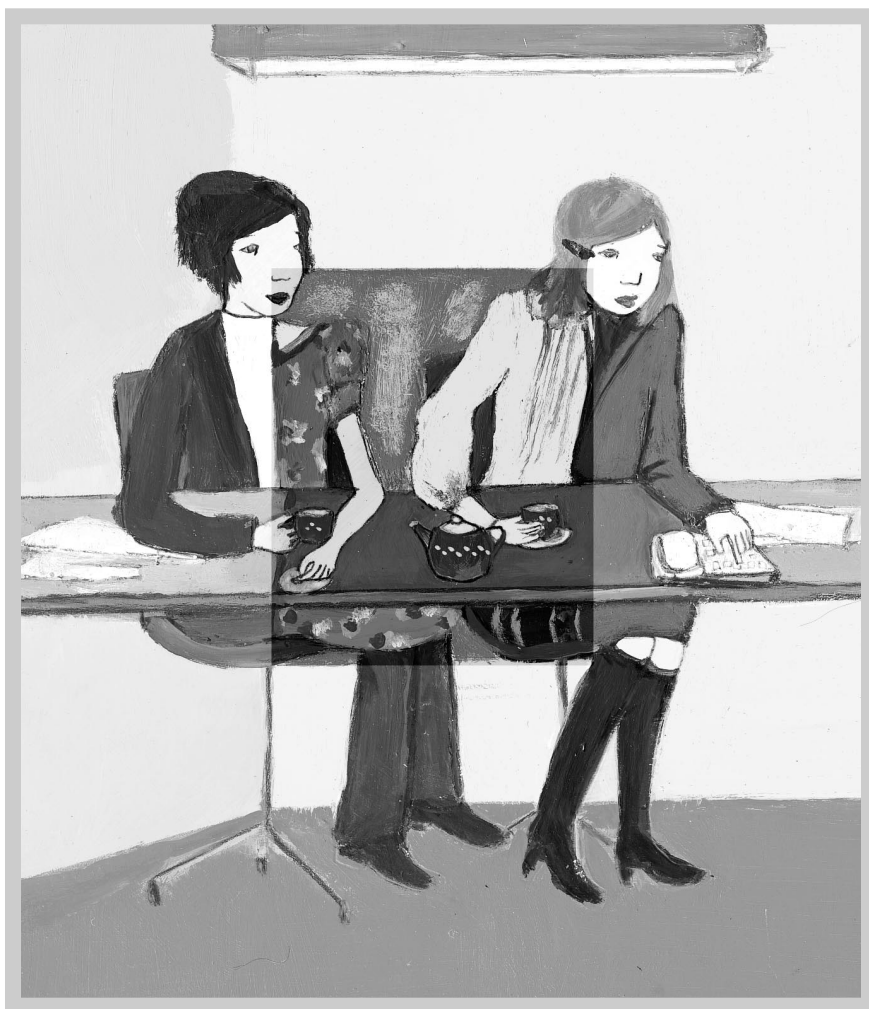
The ties to employees, customers, suppliers, distributors, and shareholders

Shackles

Values

The set of shared beliefs that determine corporate culture

Dogmas



As a strategic frame grows more rigid, managers often force surprising information into existing schema or ignore it altogether.

attacks. The hard-won lesson from the First World War became a tragic blinder during the Second.

When strategic frames grow rigid, companies, like nations, tend to keep fighting the last war. When Xerox's management surveyed the competitive battlefield in the 1970s, it saw IBM and Kodak as the enemy, its 40,000 sales and service representatives as its troops, and its patented technologies as its insurmountable defenses. Xerox's frames enabled the company to fight off traditional foes using established tactics and to rebuff repeated attempts by IBM and Kodak to attack its core market. But the strategic frames blinded Xerox to the new threat posed by guerrilla warriors such as Canon and Ricoh, which were targeting individuals and small companies for their high-quality compact copiers.

Once Xerox's management recognized the magnitude of the threat from the new entrants, it belatedly but aggressively launched a series of quality programs designed to beat the Japanese at their own game. These initiatives did stem Xerox's share loss, and the company's victory over the Japanese was trumpeted in books with titles like *Xerox: American Samurai*. The focus on beating the Japanese, however, distracted Xerox's management from the emerging battle for the personal computer. At the time, Xerox's Palo Alto Research Center was pioneering several of the technologies that sparked the personal computer revolution, including the graphical user interface and the mouse. But Xerox was unable to capitalize on the new opportunities because they lay outside its strategic frames.

Processes harden into routines.

When a company decides to do something new, employees usually try several different ways of carrying out the activity. But once they have found a way that works particularly well, they have strong incentives to lock into the chosen process and stop searching for alternatives. Fixing on a single process frees people's time and energy for other tasks. It leads to increased productivity, as employees gain experience performing the process. And it also provides the operational predictability necessary to coordinate the activities of a complex organization.

But just as with strategic frames, established processes often take on a life of their own. They cease to be means to an end and become ends in themselves. People follow the processes not because they're effective or efficient but because they're well known and comfortable. They are simply "the way things are done." Once a process becomes a routine, it prevents employees from considering new ways of working. Alternative processes never get considered, much less tried. Active inertia sets in.

At Firestone, the routinization of processes was one of the major impediments to an effective response to radial technology. The company ran into manufacturing and quality problems because it tried to accommodate radial production by just tweaking its existing processes. Firestone produced tires that no one wanted because its capital-budgeting process promoted unnecessary investments in capacity—the capital outlays were driven by frontline managers who, quite understandably, were not keen to volunteer their own plants for closure. And it failed to bring in people with fresh viewpoints because its executive recruitment and promotion processes concentrated on building loyalty and instilling a uniform mind-set. Even as the company struggled with change, it continued to hire and promote "people like us." In 1972, all of Firestone's top managers had spent their entire careers with the company, two-thirds had been born and

raised in Akron, and one-third had followed in their fathers' footsteps as Firestone executives.

McDonald's is another example of a company whose routines have dulled its response to shifting market conditions. In the early 1990s, the fast-food giant's operations manual comprised 750 pages detailing every aspect of a restaurant's business. For years, the company's relentless focus on standardized processes, all dictated by headquarters, had allowed it to rapidly roll out its winning formula in market after market, ensuring the consistency and efficiency that attracted customers and dismayed rivals.

By the 1990s, however, McDonald's was in a rut. Consumers were looking for different and healthier foods, and competitors such as Burger King and Taco Bell were capitalizing on the shift in taste by launching new menu items. McDonald's, however, was slow to respond to the changes. Its historical strength—a single-minded focus on refining its mass-production processes—turned into a weakness. By requiring menu decisions to pass through headquarters, the company stifled innovation and delayed action. Its central development kitchen, removed from the actual restaurants and their customers, churned out a series of products, such as the McPizza, McLean, and Arch Deluxe, but they all failed to entice diners.

Relationships become shackles. In order to succeed, every company must build strong relationships—with employees, customers, suppliers, lenders, and investors. Laura and Bernard Ashley worked diligently to win the hearts of new customers, franchisees, and investors at every step of their company's expansion. Harvey Firestone, Sr., maintained close friendships with his customers, provided loans out of his own pocket to struggling tire dealers during the Great Depression, and socialized with many of his company's top executives. Firestone and the Ashleys, like many successful executives, wove the warp of economic transactions with the woof of social relationships to strengthen the fabric of their companies.

When conditions shift, however, companies often find that their relationships have turned into shackles, limiting their flexibility and leading them into active inertia. The need to maintain existing relationships with customers can hinder companies in developing new products or focusing on new markets.¹ Kirin Brewery, for example, gained control of a daunting 60% share of the postwar Japanese beer market by building strong relationships with businessmen, many of whom had received the company's lager as part of their rations in the army. In the 1980s, Kirin was reluctant to alienate its core customers by offering the trendy dry beer favored by younger drinkers. Kirin's slow response allowed Asahi Breweries to catch up and then surpass it as the industry leader.

Managers can also find themselves constrained by their relationships with employees, as the saga of **Apple Computer** vividly illustrates. Apple's vision of technically elegant computers and its free-wheeling corporate culture attracted some of the most creative engineers in the world, who went on to develop a string of smash products including the Apple II, the Macintosh, and the PowerBook. As computers became commodities, Apple knew that its continued health depended on its ability to cut costs and speed up time to market. Imposing the necessary discipline, however, ran counter to the Apple culture, and top management found itself frustrated whenever it tried to exert more control. The engineers simply refused to change their ways. The relationships with creative employees that enabled Apple's early growth ultimately hindered it from responding to environmental changes.

Banc One is another company that was hamstrung by its relationships with employees—in particular, its managers. Growing from humble beginnings, Banc One became the most profitable U.S. bank in the early

Are You Suffering from Active Inertia?

Active inertia is insidious by nature. Because it grows out of success, it often spreads unnoticed in corporations. Sometimes, in fact, what managers consider to be their company's strengths are actually signs of weakness. If many of the following statements ring true for your company, you may want to take a fresh look at your strategic frames, processes, relationships, and values.

"We know our competitors inside out."

"Our top priority is keeping our existing customers happy."

"We're not the world's greatest innovators, but we run a tight ship."

"Our processes are so well tuned that the company could practically run itself."

"We focus R&D on product refinements and extensions, not on product breakthroughs."

"We're skeptics. In our view, the leading edge is the bleeding edge."

"We can't allow ourselves to get distracted by all the new fads in the marketplace."

"We have a very stable top-management team."

"We have a well-entrenched corporate culture."

"We will never relinquish our core competency."

"Our processes are world class, and we follow them religiously."

"If it ain't broke, we don't fix it."

"We have high levels of employee loyalty, but when we bring in talented new people, they often get frustrated and leave."

"We've carved out an enduring leadership position in our industry."

"We view our current distributors as key strategic partners. We don't want to alienate them by rushing into new channels."

"Our corporate values are sacred; we'll never change them."

1990s, with a market capitalization that topped that of American Express and J.P. Morgan. Its formula for success was to acquire healthy local banks, retain their incumbent managers, and grant those managers considerable autonomy in running their businesses. These “uncommon partnerships,” as Banc One dubbed the relationships, motivated the managers to act as entrepreneurs and respond to local market conditions.

But as consolidation and deregulation changed the banking industry, Banc One began to struggle. Many of its best customers were being stolen by aggressive new competitors like Fidelity Investments, and the high cost of its decentralized, locally focused operations put it at a disadvantage to more efficient rivals like First Union and NationsBank. Banc One was slow to standardize its products and centralize its back-office operations because it knew that such moves would curb the autonomy of the local bank managers. It regained its upward momentum only after its CEO, John B. McCoy, decided to abandon the cherished uncommon partnerships altogether.

Relationships with distributors can also turn into shackles. Dell Computer has surged ahead of rival PC makers by selling directly to customers. Incumbents like Hewlett-Packard and IBM have been slow to copy Dell’s model, fearing a backlash from the resellers who currently account for the vast majority of their sales. Airlines like Lufthansa, British Airways, and KLM face a similar dilemma. They’ve been slow to promote direct sales—over the Internet, for example—because they don’t want to antagonize the travel agents they rely on for filling seats.

Values harden into dogmas. A company’s values are the set of deeply held beliefs that unify and inspire its people. Values define how employees see both themselves and their employers. The “Firestone man,” for example, exemplified loyalty to the company and a deep commitment to the community. Values also provide the centripetal force that holds together a company’s far-flung operations. Laura Ashley franchisees rallied around the banner of

the company’s traditional values, helping to create a strong brand identity around the world.

As companies mature, however, their values often harden into rigid rules and regulations that have legitimacy simply because they’re enshrined in precedent. Like a petrifying tree, the once-living values are slowly replaced by the cold stone of dogma. As this happens, the values no longer inspire, and their unifying power degenerates into a reactionary tendency to circle the wagons in the face of threats. The result, again, is active inertia.

Polaroid’s steady decline illustrates how once-vibrant values can ossify. Founded by inventor Edwin Land, Polaroid rose to prominence by pioneering a series of exciting technologies like instant photography, and its employees prided themselves on the company’s R&D leadership. But over time, Polaroid’s devotion to excellent research turned into a disdain for other business activities. Marketing and finance, in particular, were considered relatively unimportant so long as the company had cutting-edge technology. Valuing technological breakthroughs above all else, Polaroid’s managers continued to invest heavily in research without adequately considering how customers would respond. Not surprisingly, sales stagnated. Today the company is worth only one-third of what a bidder offered in an acquisition attempt in 1989.

Royal Dutch/Shell is another company whose values became a hindrance. During the 1930s, Shell was dominated by Henri Deterding, who was a strong leader and a Nazi sympathizer. Shell’s other executives finally forced Deterding out, and the painful episode imprinted on the company a distaste for central control—a value that came to permeate its culture and led to the establishment of fiercely independent country managers. The decentralized structure enabled Shell to seize growth opportunities around the world. But when oil prices fell during the 1990s, the belief in decentralized authority prevented the company from quickly rationalizing its operations and cutting costs.

Renewal, Not Revolution

Success breeds active inertia, and active inertia breeds failure. But is failure an inevitable consequence of success? In business, at least, the answer is no. While Firestone floundered, Goodyear made a smooth transition to radial tires, emerging as one of the three global powers in the tire industry. While Laura Ashley continued its downward drift, Gucci righted itself after a brief stumble. History reveals many such pairs of industry leaders whose fates diverged when they were forced to respond to environmental changes. Think of General Electric and Westinghouse, Volkswagen and Renault, Samsung and the Hanjin Group, Southwest Airlines and People Express.

Successful companies can avoid—or at least overcome—active inertia. First, though, they have to break free from the assumption that their worst enemy is paralysis. They need to realize that action alone solves nothing. In fact, it often makes matters worse. Instead of rushing to ask, “What should we do?” managers should pause to ask, “What hinders us?” That question focuses attention on the proper things: the strategic frames, processes, relationships, and values that can subvert action by channeling it in the wrong direction.

Most struggling companies have a good sense of what they need to do. They have stacks of reports from inside analysts and outside consultants, all filled with the same kinds of recommendations. Firestone’s leaders were well aware of the superiority of the radial tire, and Laura Ashley’s executives knew that more and more women were joining the workforce. Their problem was that they lacked a clear understanding of how their old formulas for success would hinder them in responding to the changes.

Even after a company has come to understand the obstacles it faces, it should resist the impulse to rush forward. Some business gurus exhort managers to change every aspect of their companies simultaneously, to foment revolution within their organizations. The assumption is that the old formulas need to be thrown

to the wind—and the sooner, the better. But the veterans of change programs whom I've talked to argue against that approach. They say that by trying to change everything all at once, managers often destroy crucial competencies, tear the fabric of social relationships that took years to weave, and disorient customers and employees alike. A revolution provides a shock to the system, but the shock sometimes proves fatal.

Look at what happened when Firestone finally recognized the obstacles that were preventing it from succeeding. In 1980, Firestone's board brought in a CEO known for his prowess as a turnaround artist. The

new chief executive wasted no time. He closed five of the company's 14 domestic plants, severed its longstanding relationships with several customers, replaced the bottom-up capital-budgeting process with a strict top-down approach, and filled key management posts with a crew of outsiders. (See the insert "The Inside-Outsider as Change Leader.")

The new CEO's revolution saved Firestone from bankruptcy, but it left the company poorly positioned for future growth. The team of outside managers disposed of several of Firestone's most promising businesses and invested heavily in tire retailing, despite warnings from sea-

soned insiders that the company's tire stores had never been profitable. Firestone's days as an independent company were numbered.

Goodyear, by contrast, took a very different path. Respectful of its corporate heritage but not beholden to it, Goodyear adapted to the new competitive environment through a series of carefully staged changes, avoiding the need for a revolution. The company cut its production capacity for traditional tires in a way that showed respect for its longstanding commitments to workers and communities. Wherever possible, it converted existing factories to radial production or built new radial

The Inside-Outsider as Change Leader

Guiding a company through big changes requires a difficult balancing act. The company's heritage has to be respected even as it's being resisted. It's often assumed that outside managers are best suited to lead such an effort, since they're not bound by the company's historical formula. Lou Gerstner's success in turning IBM around is frequently held up as evidence of the need for an outsider. I would argue, though, that Gerstner should be viewed more as an exception than an example. Typically, outsiders are so quick to throw out all the old ways of working that they end up doing more harm than good.

The approach I recommend is to look for new leaders from within the company but from outside the core business. These managers, whom I call inside-outsiders, can be drawn from the company's smaller divisions, from international operations, or from staff functions. Charles Pilliod, for example, the CEO who led Goodyear into the radial age, was born and raised in Akron and worked his entire career with Goodyear. But he had spent 29 of his 31 years prior to taking the helm at Good-

year in the company's international division, where he had watched the rapid spread of radials in Europe. He understood the company's heritage, but he could see it from the objective viewpoint of an outsider.

Inside-outsiders have led many of the most dramatic corporate transformations in recent times: Jack Welch spent most of his career in GE's plastics business; Jürgen Schrempp was posted in South Africa before returning to run Daimler-Benz, now DaimlerChrysler; and Domenico De Sole served as the Gucci Group's legal counsel before leading that company's dramatic rejuvenation.

Another alternative is to assemble management teams that leverage the strengths of both insiders and outsiders. When Gerstner took over at IBM, he didn't force out all the old guard. Most operating positions continued to be staffed by IBM veterans with decades of experience, but they were supported by outsiders in key staff slots and marketing roles. The combination of perspectives has allowed IBM to use old strengths to fuel its passage down an entirely new course.

Finally, inside managers can break free of their old formulas by imagining themselves as outsiders, as Intel's executives did in deciding to abandon the memory business. Intel had pioneered the market for memory chips, and for most of its executives, employees, and customers, Intel meant memory. As new competitors entered the market, however, Intel saw its share of the memory business dwindle from more than 90% in the early 1970s to about 5% a decade later. At the same time, increasing industry capacity was stifling prices.

Although Intel had built an attractive microprocessor business during this time, it clung to the memory business until its chairman, Gordon Moore, and its president, Andy Grove, sat down and deliberately imagined what would happen if they were replaced with outsiders. They agreed that outsiders would get out of the memory business—and that's exactly what Moore and Grove did. While a company's competitive formula exerts a tremendous gravitational pull, thinking like outsiders can help insiders to break free.

facilities adjacent to closed plants, retaining most employees and thus mitigating the disruption to the communities. And whereas Firestone radically reduced its level of customer service, Goodyear continued to invest in its customer relationships, establishing a basis for future growth.

If ever there appeared to be a candidate for revolution it was IBM in 1993. When Lou Gerstner left RJR Nabisco to take the helm at IBM, he entered a company that had lost more than \$16 billion in three years, had been singled out as a dinosaur by *Fortune*, and was in the process of being carved into 13 divisions that could be sold off in chunks. Gerstner shook up the hidebound IBM culture and slashed costs, but he also preserved and nurtured many of IBM's traditional strengths. Rather than ape the freewheeling style of Silicon

Valley companies, Gerstner emphasized IBM's reputation for stability and responsibility. He reassured corporate customers that they could rely on Big Blue to help them move into the world of networked computers. Instead of abandoning IBM's mainframe business, Gerstner expanded services and acquired software that complemented IBM's heavy metal, enabling the company to offer "total solutions" to customers' information technology needs. Gerstner's strategy of transforming IBM through renewal rather than revolution has succeeded beyond anyone's expectations, leading to a more than fourfold increase in the company's share price and positioning it to continue as an industry leader into the next century.

IBM's turnaround offers an important lesson to any successful company facing big changes. Active iner-

tia exists because the pull of the past is so strong. Trying to break that pull through a radical act of organizational revolution leaves people disoriented and disenfranchised, cut off from the past but unprepared to enter the future. It's better for managers to respect the company's heritage. They should build on the foundations of the past even as they teach employees that old strategic frames, processes, relationships, and values need to be recast to meet new challenges.

1. For a discussion of how relationships with customers can prevent a company from innovating, see Joseph L. Bower and Clayton M. Christensen, "Disruptive Technologies: Catching the Wave," *HBR* January-February 1995.

Product no. 4320

To place an order, call 1-800-988-0886.

ARTICLES

[“The Reinvention Roller Coaster: Risking the Present for a Powerful Future” by Tracy Goss, Richard Pascale, and Anthony Athos \(Harvard Business Review, November–December 1993, Product no. 93603\)](#)

Like Sull, these authors look at the costs of acting on the basis of outmoded assumptions and premises. Change programs usually promise incremental progress rooted in the company's previous experience. Many organizations, however, require a complete reinvention, not marginal improvement. Reinvention is not changing what already is, but creating what isn't. By conceiving a new context that leads to a break with limiting beliefs from the past, the process of reinvention creates openness to a new, seemingly impossible future.

[“Evolution and Revolution as Organizations Grow” by Larry E. Greiner \(Harvard Business Review, May–June 1998, Product no. 98308\)](#)

In their haste to leap into the future, managers fail to consider historical context—the way history can serve as a guide to the future. Companies pass through a series of developmental stages, each stage beginning with a period of evolution that is marked by steady growth, and ending with a period of revolution that is marked by turmoil. By knowing where they are in the company's developmental sequence, managers can learn to identify appropriate actions and solutions. The critical task during the revolutionary periods is to find a new set of organizational practices that will carry the organization into its next phase of evolutionary growth.

[“Leading Change: Why Transformation Efforts Fail” by John P. Kotter \(Harvard Business Review, March–April 1995, Product no. 4231\)](#)

For companies who've recognized the need to change in response to new market conditions, this article by Kotter provides a rational sequence for working through the change process. Kotter bases his insights on the transformation efforts he witnessed at more than 100 companies over ten years. His first major lesson is that a change process goes through a series of phases that usually require considerable time. His second lesson is that serious mistakes in any of the phases can have a devastating impact on the process as a whole. To help companies avoid that, Kotter examines eight big errors that block successful renewal, from failing to establish a sense of urgency to not anchoring changes in the corporation's culture.

Visit us on the Web at:



Harvard Business Online

THE WEBSITE OF HARVARD BUSINESS SCHOOL PUBLISHING

U.S. and Canada: 800-988-0886

617-783-7500 • Fax: 617-783-7555